Supreme Court, U.S.
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No. 92-1370

In The

Supreme Court of the United States

October Term, 1993

In re: BFP, a Partnership,

Debtor,

BFP, a Partnership,

Petitioner,

vs.

RESOLUTION TRUST CORPORATION as Receiver of Imperial Savings & Loan Association; PAUL OSBORNE; WILLIAM LITTLE; DENNIS ROY; ARTHUR RITZ; JOSE CRUZ; RICHARD MARCZ,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF FOR JIM WALTER HOMES, INC. AS AMICUS CURIAE SUPPORTING RESPONDENTS

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BRIEF FOR JIM WALTER HOMES, INC. AS AMICUS CURIAE SUPPORTING RESPONDENTS

INTEREST OF JIM WALTER HOMES, INC.,

Jim Walter Homes, Inc. is a Florida corporation having its home office in Tampa, Florida. The nature of business of the company is the financing and construction of single family homes in various stages of construction from a shell to a completed, two-story home. By the very nature of the company's market, it is largely limited to building and financing homesteads for low-income families, including those on some form of disability compensation or social security benefits.

The company actively does business in twenty-three states, namely, Oklahoma, Texas, Louisiana, Arkansas, Missouri, Georgia, Alabama, Florida, North Carolina, South Carolina, Virginia, Kentucky, Tennessee, New Mexico, Illinois, Arizona, Mississippi, Ohio, West Virginia, Pennsylvania, Maryland, Indiana, and Delaware.

Jim Walter Homes, Inc. presently services a mortgage loan portfolio of $4,180,000,000.00 covering 88,500 accounts in those states. The company's default ratio is 4.47% compared with the national average reported by the American Banker's Association of 5.26%. The relative success of this company is based primarily upon an aggressive loan servicing system of field personnel as well as an aggressive foreclosure policy. As such, the company is active in obtaining title to defaulting properties and immediately re-selling them to third parties. Such activity is the very *lebensblut* of the company's survival in such a volatile market. To require the holding of

such acquired houses for one year following foreclosure sale by reason of § 548 would involve the interest paid on the investment, and the payment of insurance and taxes, as well as the management of the houses to minimize vandalism, theft, and deterioration from the elements. It is fundamental knowledge that in the winter homes must be heated in order to avoid deterioration.

By reason of the vast experience of the company in the mortgage foreclosure arena, we feel our participation in this appeal lends a vast reservoir of experience in foreclosure law and how that experience relates to the increasing number of bankruptcies. The ability to sell repossessed properties without uncertainty or restraint is the very essence of the company's success in maintaining a stable mortgage portfolio.

The company recently participated in the case of *Rake v Wade*, 113 S.Ct. 2187 (1993), since Wade is the Trustee of a portion of the company's mortgage portfolio. A Bankruptcy decision such as the one at bar is crucial to the ability of the company to recover and re-sell properties which have been the subject of foreclosure. There is a need for uniformity throughout the United States such that companies that do business must be able to rely upon applicable substantive state law as to the validity of foreclosures rather than some arbitrary floor or a case by case analysis one year later after the property has been sold to an innocent third party.

STATUTORY PROVISIONS INVOLVED

Sections 101(54), 548(a)(2)(A), 548(d)(1) of the Bankruptcy Code, 11 USC are involved in this case and are set forth in the Appendix, *infra*.

INTRODUCTION AND SUMMARY OF ARGUMENT

1. The various state laws wherein Jim Walter Homes, Inc. conducts business and the standards relative to vacation of foreclosure sales are discussed for the Court's consideration.

2. The majority of states discussed utilize power of sale or trustee sales without appraisal or requirement for minimum bid. The majority of those states will not vacate a sale based upon minimum bid alone absent fraud, mistake, collusion, or other defect in the sale; the minority of the states discussed will vacate a sale if the price bid is so low as to "shock the conscien of the court." Most of the states do not inquire as to market value unless the proceeding involves a request for deficiency judgment. Very few states require a two-thirds bid of a court appraised value before the sale is judicially confirmed.

3. It is not fraud to perform an act or fail to perform an act which the law allows. It is not a fraudulent conveyance nor are creditors injured by the sale of a homestead since that exempt property is beyond the reach of creditors.

4. It is the general rule that a transfer prior to bankruptcy of exempt property is not affected by the failure to claim the previously transferred property as exempt since

pre-filing exempt property does not pass to the trustee and is of no concern to the trustee or the creditors he represents.

5. Congress has expressed a policy of special treatment of mortgages upon the homesteads of Debtors. Congress has not expressed a policy of disregard of substantive state law as it relates to mortgage foreclosure sales and state tax sales.

6. It cannot be inferred by the Courts that Congress intended to preempt state substantive law as it relates to foreclosure sales and tax sales.

ARGUMENT

A GENERAL OUTLINE OF THE LAW OF THE STATES WHEREIN THE AMICUS DOES BUSINESS INDICATES MOST STATES UTILIZE POWER OF SALE AS A FORECLOSURE DEVICE. A MINORITY OF STATES REQUIRE JUDICIAL FORECLOSURE WITH APPRAISAL AND A MINIMUM BID OF TWO-THIRDS OF THE APPRAISED VALUATION.

A consideration of the states wherein *amicus*, hereinafter termed JWH, does business indicates the diversity of state law applicable to foreclosures and the consideration paid at those foreclosure sales.

Oklahoma: Oklahoma requires foreclosure by action wherein, prior to sale, the property is appraised by court-appointed appraisers. To purchase the property, *any* bidder must bid at least two-thirds of the appraisal. The time and place of the sale is advertised by publication and mailing for three consecutive weeks and by mailing the

notice of sale to all other interested parties. The sale is subject to judicial review at confirmation of the sale. Mere inadequacy of price in absence of fraud or irregularity is not a ground for refusal to confirm the sale. *City of Wewoka v Fink*, 173 P.2d 936 (Okla. 1946). The Court there held at 938:

> The only test a court can have of the value of property sold at a *forced* sale is the price it would bring on due notice at a public sale fairly conducted.

Missouri: That state does not require appraisal, nor are there provisions for a minimum bid in their non-judicial foreclosures. Again, mere inadequacy of consideration is not sufficient to invalidate a sale in absence of fraud as evidenced by gross inadequacy of consideration, the test being the price should not be so low as to "shock the conscience of the court." *Blades v Ossenfort*, 481 S.W.2d 531 (Mo. App. 1972), or "so inadequate as to shock the moral sense and outrage the conscience." *Robert R. Wisdom Oil Co., Inc. v Gatewood*, 682 S.W.2d 882 (Mo. App. 1984).

Mississippi: Foreclosure sales are conducted without a minimum bid or appraisal. An early case approved a sale of 50% of the value of the land. *Triplett v Bridgeforth*, 38 So.2d 756 (Miss. 1848). More recently, where the market value was $392,897.00 of property, and appellees established a total indebtedness of $185,530.00, a bid of $85,530.00 resulted in a conveyance to the purchaser at the sale. See *Lake Hillsdale Estates, Inc. v Galloway*, 473 So.2d 461 (Miss. 1985). The rule was amplified in *Wansley v First National Bank of Vicksburg*, 566 So.2d 1218, 1225 (Miss. 1990) as follows:

> Subject to our otherwise governing statutes, we declare that, if the secured creditor is authorized to foreclose by power of sale, after the debtor's default and upon compliance with the deed of trust or other instrument, the secured creditor may sell any or all of the real estate that is subject to the security interest in its then condition or after any reasonable rehabilitation or preparation for sale. Every aspect of the sale, including the method, advertising, time, place, and terms, must be commercially reasonable. This is an objective standard.

New Mexico: No appraisal or minimum bid is required at judicial sales. The test is that the bid must not be so low as to shock the conscience of the court.

Kentucky: Sales are conducted pursuant to court order where after required appraisal, a bid of two-thirds is required to cut off redemption rights. If a bid is for less than two-thirds, the owner may redeem by paying within one year from sale date the original purchase money together with ten percent interest.

Alabama: Power of sale is the mode of foreclosure where there is neither minimum bid nor prior appraisal. The standard of review is to set aside the sale if the price is grossly disproportionate to the real value of the property.

Tennessee: This state utilizes Trustee's sales without any requirement of an appraisal or a statute providing for a minimum bid.

West Virginia: This state utilizes power of sales.

Illinois: Illinois utilizes judicial sales with no appraisal and no minimum bid. The standard there is "fair and reasonable" as to amount of bid.

Ohio: Judicial sales are performed with appraisal and a requirement of two-thirds of the appraisal as a minimum bid.

Arkansas: Judicial sales are performed with appraisal and a requirement of two-thirds of the appraisal as a minimum bid.

Georgia: Georgia utilizes power of sale procedure. There is no prior appraisal and no statutory requirement for minimum bid. Within 30 days after the sale, to preserve a deficiency balance, an *in personam* action must be brought wherein it is established the property was sold for fair market value.

Texas: This state utilizes trustee's sales with no required appraisal and no statutory requirement for minimum bid. If a deficiency is sought, a hearing is conducted to determine the fair market value as of the date of sale. If no request for determination of the fair market value is made, the sale price will be used by the court to compute the deficiency.

Florida: Judicial sales are conducted with no appraisal and no minimum bid provided for.

South Carolina: Judicial sales are conducted with no appraisal and no minimum bid provided for.

North Carolina: Power of sales are utilized with no appraisal nor minimum bid.

Virginia: This state utilizes Trustee sales with no appraisal or minimum bid.

Louisiana: Judicial sales are conducted with appraisal and required two-thirds bid of the appraisal under writ *fiera*

facias. There is an alternate procedure called "executory process" wherein there is no appraisal and no minimum bid required.

Indiana: By statute judicial sales do not require appraisal or is a minimum bid provided for.

Delaware: Delaware utilizes power of sale with no minimum bid required.

Arizona: Arizona utilizes judicial sales and trustee sales, neither of which requires a minimum bid nor a prior appraisal. In that state, where the judgment creditor bid $367.41 for property with a net equity value of between $1,500 and $6,353, this 5-7% equity bid did not shock the conscience of the court. See *Mason v Wilson*, 116 Ariz. 255, 568 P.2d 1153 (1977). *Contra Homecraft Corp. v Fimbres*, 119 Ariz. 299, 580 P.2d 760 (1978) where the judgment creditor bid $623.38 and acquired a $10,000 equity, it was not error to set aside an execution sale. Arizona follows the general rule that mere inadequacy of price is not adequate to set aside an execution sale, but where the inadequacy is so great as to shock the conscience of the court, such will authorize the court to set aside the sale and order a new one.

IN POWER OF SALE STATES, THE MAJORITY RULE IS THAT INADEQUATE PRICE ALONE, ABSENT OTHER FACTORS, IS NOT A GROUND TO VACATE A SALE. THE MINORITY RULE APPLIES THE TEST OF A BID SO GROSS AS TO SHOCK THE CONSCIENCE OF THE COURT.

As can be seen by the above list of procedures, at least in the states where JWH is actively pursuing foreclosures, the preferred method is power of sale with no

requirement for appraisal and no requirement for a minimum bid. In those states where appraisal is required, we see that a bid of two-thirds of the appraised valuation is the minimum bid.

The general rule relating to power of sales in most states is that inadequate price is *alone* not sufficient to set aside the sale; however, gross inadequacy coupled with other circumstances showing unfairness or fraud will suffice. In other states, the minority rule is to evaluate the bid to determine if the amount is so low as to shock the conscience of the court.

One recent federal case regarding Nevada property but applying federal law is *U.S. v McKenzie*, 322 F. Supp. 1058 (D. Nevada 1971), *aff'd* 474 F.2d 1009 (9th Cir. 1983) which held that a disparity between the sale price and the market value was $16,550. Such a spread was held not to be so great as to shock the conscience of the court, citing *U.S. v Wells*, 403 F.2d 596 (5th Cir. 1968) and *Magnolia Springs Apts. v U.S.*, 323 F.2d 726 (5th Cir. 1963). The court approved a deficiency judgment of $89,907.35.

Berman v Nat. Acceptance Co. of America, 239 F. Supp. 767 (WD TX 1965) applied Texas law in a deed of trust sale. The court there observed at 770:

> Since the exercise of a power under the trust is a harsh remedy, the state courts have insisted on rigid adherence to the various requirements by statute and in the trust instrument itself . . .

There, the bid was $60,000 at the sale; the court held a $23,000 difference was not sufficient to vitiate the sale, the law of Texas being mere inadequacy of price alone is

not grounds for setting aside a sale. There must be something more, such as fraud or collusion.

In those states where inadequacy alone is not sufficient to set aside a sale, we submit the following authorities:

See *Britt v Smith*, 169 S.E.2d 482 (N.C. 1969); *Clarimont Development Cop. v Trust Co. Bank*, 233 S.E.2d 37 (Ga. 1977); *Musgrove v Glasgow*, 188 S.Ed.2d 94, 96 (Va. 1972) where the bid was one-third the value of the property, and the court approved the sale in absence of fraud; *Hodges v Wellons*, 175 S.E.2d 690, 692 (N.C. 1970) approved a sale where the bid was $625 for property valued at $2,600 where the court observed that "the only obligation of the trustee . . . was to conduct and consummate the foreclosure sale in accordance with law." In Georgia, it is only when gross inadequacy of price is accompanied by fraud, mistake, apprehension, surprise or other circumstances that brought about the inadequacy that a sale may be set aside. See *Giordano v Stubbs*, 184 S.E.2d 165, 169 (Ga. 1971). A case of first impression in Arizona is *Security Sav. and Loan Ass'n v Fenton*, 806 P.2d 362, 364 (Az. 1990) where it was ruled that a trustee sale cannot be set aside for inadequacy by holding that the statute relating to deficiency judgments protects the debtor where fair market value is then considered. In *Myles v Cox*, 217 So.2d 31, 34 (Miss. 1968) a bid of $3,218 was approved where the value of the property was between $6,500 and $8,000. In Florida, *Shipp Corporation, Inc. v Charpilloz*, 414 So.2d 1122, 1124 (Fla. 1982) approved a sale where the value was in the range of $2,800,000 to $3,200,000 and the bid was $1,100,000, the court saying:

> . . . a forced sale seldom brings the property's true value.

In Tennessee, a sale price of $30,000 where land was worth $90,000 was not considered inadequate by the court. See *Watson v United American Bank of Knoxville*, 588 S.W.2d 877, 882 (Tenn. 1979); however, the sale was invalidated because notice of the sale was not sent to the owner, but the rule in that state is inadequacy alone is not adequate to set aside a sale.

In Texas, absent irregularity, mere insufficiency of bid is not enough to set aside a sale. *Forestier v San Antonio Sav. Ass'n*, 564 S.W.2d 160 (Tex. Civ. App. 1978) at 165, citing as authority the Texas Supreme Court in *Tarrant Savings Ass'n v Lucky Homes, Inc.*, 390 S.W.2d 473 (Tex. 1965).

The following authorities are submitted for those states which examine the bid price as being so gross as to shock the conscience of the court:

Waring v Guy, 237 A.2d 763, 767 (Md. 1968) *citing Lewis v Beale*, 162 Md. 18, 158 Atl. 345 (1932):

> The fact that the court must consider the question at bar with reference to the circumstances that the standard is that of a forced sale, fairly made, rather than a voluntary sale by the owner, is due to the default of the debtor, who must assume the agreed consequences of the default. If the sale takes place during a period of financial depression, or of depreciation of the value of land, or of other adverse conditions for which neither party is responsible, and hardship thereby results, it is a consequence which must be borne as an incident of the contract, and the

> court cannot relieve one party to the contract without violating the contractual right of the other.

Other cases which examine the gross disparity of the value and the bid price are *Rife v Woolfolk*, 289 S.E.2d 220 (W. Va. 1982) where the disparity was a bid of $8,000 for property valued at $62,000; *Smith v Equitable Life Assurance Society of U.S.*, 448 S.W.2d 588, 594 (Mo. 1970) where the property had a value of $35,000 and the sale price was $16,700 and the court held the bid did not represent a gross inadequacy.

Indiana looks at the situation somewhat differently in that the test is the entry of a deficiency judgment which is shocking to the court's sense of conscience and justice, holding that mere inadequacy of price alone may be sufficient to justify setting aside the sale, the test there being the price paid must be so great as to shock the sense of justice and right. *Arnold v Melvin R. Hall, Inc.*, 496 N.E.2d 63, 65 (Ind. 1986). However, an allegation of inadequate price is not in and of itself insufficient to set aside the judgment for the reason in Indiana the law presumes that the successful bid at sheriff's sale is the fair market value of the property, even though there was only one bidder, i.e., the mortgagee. The mortgagor bears the burden of proving the disparity between price and value should be shocking to the court's conscience.

Such is a reasonable summary of state substantive law governing the conduct of power of sale foreclosures. In those states which require foreclosure by action which uniformly require a bid of two-thirds of the appraised valuation, there is no real problem, except that all such sales would be voided under Petitioner's bright line rule

of 70%. It is in those states where a power of sale or trustee's sale is utilized that a controversy arises.

A typical scenario is as follows: Jim Walter Homes at a sale under power bids in 1990 $5,575, that being the balance of its mortgage. The property was thereafter sold to a third party for $10,000 *cash*. That purchaser sold the property 90 days later to a neighbor who wanted the property because it adjoined his property for a price of $17,500. Now, a year later the bankruptcy court desires to apply the 70% rule to a valuation and obtain the difference from the mortgage company. Jim Walter Homes broke no law, engaged in no collusion or fraud, and the question begs if it is fair and lawful that American business is to be conducted under this cloud.

IT IS NOT CONSTRUCTIVE FRAUD TO DO WHAT THE LAW ALLOWS.

A CONVEYANCE OF HOMESTEAD WHICH IS EXEMPT FROM THE CLAIMS OF UNSECURED CREDITORS FURNISHES NO GROUND FOR COMPLAINT UNDER FRAUDULENT CONVEYANCE LAW.

A PRIOR CONVEYANCE OF HOMESTEAD PASSES NO RIGHTS TO THE TRUSTEE IN BANKRUPTCY AND IS OF NO CONCERN TO THE TRUSTEES OR THE CREDITORS.

The legal basis for setting aside a state law foreclosure proceeding where the property was sold in strict conformity with state law is constructive fraud; however, it is fundamental law that it is not fraud to do what the law allows and provides for.

> . . . the law will not deduce fraud from any number of acts, each of which is lawful and

innocent in itself. 37 CJS, Fraudulent Conveyances, § 7, p. 856.

In all of the foreclosures conducted by Jim Walter Homes, Inc. throughout the states, the transfers by sale involve the homestead of the mortgagors. In all those states, the homesteads are exempt property.

> . . . as a general rule a conveyance of a homestead which is exempt from liability from debts is not a fraud on creditors and furnishes no ground for complaint. 37 CJS, Fraudulent Conveyances, § 31, p. 878.
>
> . . . fraud in order to be actionable must result in injury, and the creditor is not injured by a conveyance of property which he cannot subject to his claims. *Ibid.*

Examples of state courts which have sustained the general rule that it is not fraud to do what the law allows are *The Colonial Nat'l Bk v J. H. Bredenkamp, Jr.*, 151 Ind. App. 366, 279 N.E.2d 845, 848 (1972) and *Earl v Liberty Loan Corp. of West Monroe, Inc.*, 193 So.2d 280, 282 (La. App. 1966)

Federal Courts which have applied the law declaring that it is not a fraudulent conveyance when the asset is the exempt homestead are *Smith v Jackson State Bank*, 63 F.2d 934, 936 (10th Cir. 1933); *Sieb's Hatcheries, Inc. v Lindley*, 209 F.2d 674, 676 (8th Cir. 1954). The Tenth Circuit involved a bankruptcy case in *Rutledge v C.R. Johansen*, 270 F.2d 881 (10th Cir. 1959). That case involved an action by the trustee to set aside a voidable preference under 11 USCA §§ 96, 64 and 60, subs, a and b. The bankrupt had made a conveyance in satisfaction of an antecedent debt involving his homestead and did not claim an exemption

in his schedules. The court in holding that such a transfer does not give rise to a voidable preference stated:

> The statement is grounded in the legal concept that property exempt by law remains in the bankrupt, does not pass to the trustee, and the bankrupt's disposition of it prior to bankruptcy is therefore of no concern to the trustee or the creditors he represents. Citing *Lockwood v Exchange Bank*, 190 U.S. 294, 23 S. Ct. 751, 47 L.Ed. 1061; *First National Bank of Cleveland v Orten*, 43 Okl. 325, 142 Pac. 1096; Annotation 161 ALR 1013-1018. 270 F.2d at 881.

Countering the argument the bankrupt did not claim the exemption at the later bankruptcy, the court said "if the bankrupt had the right to transfer his exempt property prior to bankruptcy without committing a voidable preference, there was no exemption rights to be exercised in bankruptcy, and appellant's argument must fail." The court held the active steps to claim bankruptcy exemptions provided for in the Code apply only to property of which the bankrupt was seized at the time of filing. To hold otherwise would be to give creditors a right to exempt property they did not have prior to the filing. 270 F.2d at 882.

It is appropriate, however, to point out that *Rutledge* was distinguished in the later case of *Mansell v Carroll*, 379 F.2d 682 (10th Cir. 1967). The same Jurist who decided *Rutledge* pronounced the decision. In *Mansell*, the transfer was not free of fraud. Although acknowledging the law in *Rutledge* " . . . is, wisely, the general rule of law . . . " in this case there was an active plan and a scheme on the

part of the bankrupt and his wife to transfer the property for a fraudulent purpose. 379 F.2d at 684.

One cannot leave this point of law without examining *Lockwood v Exchange Bank*, 190 U.S. 294, 23 S.Ct. 751, 47 L.Ed. 1061 (1903). That case involved the bankruptcy act of 1898 regarding property which is exempted by the law of the state in which the debtor resides. The case stands for the proposition that the exempt property does not pass to the trustee, even if the bankrupt has under the law of the state waived his exemption in favor of certain of his creditors. This was evidently the law under the bankruptcy act of 1867 as well. *In re Bass*, 3 Woods 382, 384 (1877) which said:

> In other words, it made as clear as anything can be, that such exempted property constitutes no part of the assets in bankruptcy. The agreement of the bankrupt in any particular case to waive the right to the exemption makes no difference. He may owe other debts in regard to which no such agreement has been made, but whether so or not, it is not for the bankruptcy court to inquire. The exemption is created by the state law, and the assignee acquires no title to the exempt property. If the creditor has a claim against it he must prosecute that claim in a court which has jurisdiction over the property, which the bankrupt court has not.

The court noted that the fact the act of 1898 gave the bankruptcy court authority to control exempt property afforded no ground for holding that the court of bankruptcy must administer and distribute such property.

It is to be noted as well that the current Code 11 USCS § 522(b)(2)(B) also excludes property of the estate

"to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law."

This line of law is the very reason why the *amicus curiae* position of Jim Walter Homes, Inc. is important to a complete examination of the case at bar.

THE BUTNER RULE SHOULD APPLY TO THIS CASE TO JUSTIFY THE APPLICATION OF STATE SUBSTANTIVE LAW TO THE TEST OF FRAUDULENT CONVEYANCE.

The Supreme Court has graciously consented to consider an unusual number of bankruptcy cases in the recent years. Such cases are not mundane or dog cases but are important to the very fabric of the economic engine of this country. The reason they have become so important is to cure the penchant of the lower courts on frequent occasion to ignore the plain language of the statute, not paying attention to the plain language of the text. In so doing, those lower courts have frequently ignored fundamental substantive state rights.

Such a concern was voiced in *Dewsnup v Timm*, 112 S.Ct. 773, 779 (1992) relating to the relative ease in which the lower courts were reducing the secured creditor's lien involuntarily by means other than full payment. The serious practice of applying this violence toward chapter 13 secured creditors upon the residence of the debtor by bifurcation or lien splitting was as well halted in *Nobleman v American Sav. Bank*, 113 S.Ct. 2106 (1993). What is clear from a reading of *Nobleman* is that in absence of a controlling federal rule, the determination of property

rights as enunciated in *Butner v United States*, 440 U.S. 48, 54-55, 99 S.Ct. 914, 918, 59 L.Ed.2d 136 (1979), has been left to state law, subject, of course to the alteration of remedies of a mortgagee. See *United Savings Assn. of Texas v Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 369-370, 108 S.Ct. 626, 629-630, 98 L.Ed.2d 740 (1988).

Nobleman made it clear, at least under 11 USCS § 1322(b)(2), the lower courts cannot modify the mortgagee's rights to interest rates, payment amounts, *"and other contract terms."* This last term, in *Rake v Wade*, 113 S.Ct. 2187 (1993), this court by reading the plain text of the Bankruptcy Code (§ 1325(a)(5)) reversed over fifteen circuit judges who had refused to give attention to text in denying interest to a secured creditor who was forced to forebear the arrearages over several years without interest.

Now, the Court is called upon again to halt another transgression of the lower courts in their slavish adherence to *Durrett v The Washington National Insurance Co.*, 621 F.2d 201 (5th Cir. 1980). That case is flawed in several instances. In the first place, there is no judicial basis for the arbitrary assessment of a 70% guideline for the courts to follow doggedly. There is no federal statute relating to such a guideline; there is no word in the bankruptcy act which would come close to validate such an application. Had the Fifth Circuit adhered to state law of Texas, they would have seen that mere inadequacy of price at a sale is alone insufficient to set aside a sale, absent fraud, mistake, etc. As well, their stating that they had been unable to find a case where a sale of less than 70% under the Bankruptcy Act had been approved was the barest form of dictum. See *In re Littleton*, 888 F.2d 90, 92 (11th

Cir. 1989), which condemned the "bright line" rule of *Durrett*, claiming that failing to realize that other factors are just as important, such as the bargaining position of the parties and the marketability of the property, that a sale in a foreclosure market brings less than one in a retail market, and that sale of property worth $1,000,000 for $700,000 might not constitute reasonably equivalent value even though the 70% standard is met. The Eleventh Circuit rejected that bright line rule since it would produce an unfair result, especially in light of the fact the sale extinguished junior liens on the property.

In vacating the lower court's talismanic adherence to the 70% rule, *Matter of Grissom*, 955 F.2d 1440 (11th Cir. 1992) was laudable in its criticism of both *Durrett* and *Littleton*. Certain points were made in that case which are worthy of examination:

> Absent fraud, collusion, or irregular or unlawful procedures, courts should presume that a legitimate foreclosure sale brings a price which is reasonably equivalent to the property's value.
>
> In addition, courts should consider whether or not the foreclosing party obtained a fair appraisal of the property before selling it, the extent to which the foreclosure sale was advertised, and the competitive conditions surrounding the sale.
>
> On the other hand, we also realize that allowing commercial entities to ignore equity in foreclosure proceedings undermines one crucial policy of Section 548 – ensuring that bankruptcy estates will not be unnecessarily depleted.
>
> Nullifying a legitimate foreclosure sale solely because the market for the property sold could

not bring 70% of the property's value may advance bankruptcy policy, but it also violates the policy protecting the rights of secured creditors and diminishes the integrity of foreclosure sales.

Similarly, we allow the interests of secured creditors to trump bankruptcy policy when we give a commercial lender *carte blanche* to ignore the equity interests of a borrower as long as the lender follows the minimal requirements of state foreclosure law.

After all, sale prices obtained at regularly conducted, non-collusive, lawful foreclosure sales are presumed to be reasonably equivalent values, unless the bankruptcy trustee establishes otherwise. 955 F.2d at 1446-1449.

The Sixth Circuit's view reflected *In the Matter of Winshall*, 758 F.2d 1136 (6th Cir. 1985) is probably the most rational approach to the tension between state substantive law and § 548. Congress does not write "on a clean slate" when it enacts bankruptcy statutes. *Dewsnup v Timm, supra*, at 779. When Congress sought to continue the fraudulent conveyance statute, it did so with the dictates of *Butner* clearly in mind. If we are to give effect to that most cited case, then the holding of *Winshall* is most appealing:

> While the power of the trustee to avoid certain preferential transfers was clearly intended to assure the equitable distribution of a debtor's assets among unsecured creditors, it can hardly be argued that Congress intended the rights of such creditors necessarily to override those of good faith purchasers at state foreclosure sales

or the policy judgments of states in balancing the interests of parties thereto.

The cloud created over mortgages and trust deeds by making foreclosure sales subject to being voided by a bankruptcy trustee will naturally inhibit a purchaser other than the mortgagee from buying at foreclosure. This tends to depress further the prices of foreclosure sales and thus increases the potential size of the deficiency in each foreclosure. 758 F.2d at 1139

Even if the sale in question were a transfer subject to § 548, the better view is that reasonable equivalence for the purposes of a foreclosure sale under § 548(a)(2)(A) should be consonant with the state law of fraudulent conveyances.[1]

In the Matter of Bundles, 856 F.2d 815 (7th Cir. 1988) attempted to reconcile § 548 with the dictates of the wisely decided *Butner*, but fell back upon the issue they could not concern themselves with the policy considerations of ignoring state law but instead read § 548 as establishing "a federal basis – independent of state law – for setting aside a foreclosure sale." 856 F.2d at 822. The court, however, softened the application of *Durrett* and fell back to a case-by-case adjudication:

> Consequently, it is appropriate to consider, as a starting point, the fair market value. However,

---

[1] It is important to note that Michigan law provides that inadequate sale price, in and of itself, is an insufficient ground for setting aside a foreclosure sale by advertisement. There must be both a grossly inadequate sale price and some other defect such as fraud, mistake, unfairness, or irregularity.

the fact that the sale was the result of a foreclosure rather than an arm's length transaction between a willing buyer and a willing seller is also of considerable importance. Therefore, the bankruptcy court must focus ultimately on the fair market value as affected by the fact of foreclosure. As a practical matter, the foreclosure sale price is the only means of measuring the effect of foreclosure on the value of the property . . . However, the bankruptcy court also must examine the foreclosure transaction in its totality to determine whether the procedures employed were calculated not only to secure for the mortgagee the value of its interest but also to return to the debtor-mortgagor his equity in the property. The bankruptcy court therefore must consider such factors as whether there was a fair appraisal of the property, whether the property was advertised widely, and whether competitive bidding was encouraged.

The court refused to follow state law and refused to hold a regularly conducted, noncollusive foreclosure sale should automatically be deemed a reasonably equivalent value within the meaning of § 548.

The above cases, together with the plethora of cases from the inferior courts which follow *Durrett* and which refuse to follow that case, or have modified the approach by the refusal to follow the impact of substantive state law, places this case in the same posture as *Nobleman, Dewsnup, Rake,* and *U.S. v Ron Pair Enterprises, Inc.*, 109 S.Ct. 1026 (1989). We are faced with the arbitrary refusal to accord state law property rights in a bankruptcy context. Instead, the courts refuse to follow *Butner* but have

chosen to fashion what is the rare pre-emption by Congress of state substantive property law the rule rather than the exception. One can only look at the record and observe what was said *In the Matter of Southern Land Title Corporation*, 474 F.2d 1033, 1039 (5th Cir. 1973): "The record in this case does not carry the fresh air of spring, the scent of sweet olive in bloom, and the pleasing thought of young innocents at play."

If we accept the argument of the Petitioner in this case, consider if this would not be an appropriate requirement in a title opinion by a prudent practitioner in the field of practical experience:

> It is to be noted that title of the grantor was obtained as a result of a bid at a foreclosure sale under deed of trust. Although all aspects of the sale were in conformity with state law (including the fact that the property was not required to be appraised prior to the sale), the examiner is unable to ascertain from the record whether or not the bid at the sale was for a reasonably equivalent value (whatever that term means). Since the sale took place last month, you should not consider taking title to this property until one year has passed from the sale date in order to avoid the possibility a trustee in bankruptcy may void the sale, taking the property away from you but allowing you a lien for the amount of your purchase price. Naturally, if you ignore this admonition, you are advised that it would be imprudent for you or your wife to make any improvements in the property since the trustee in bankruptcy would be the beneficiary of those improvements and you would be the loser.

Amici for the Petitioner have brought up an interesting point in applying § 548 to tax sales. They complain that in two instances the debtors did not pay their taxes on their homesteads and lost them to tax sales. *Amicus* Frank Allen, lost his home "for a mere 1% of the appraised valuation; *Amicus* McKeever's home was sold at tax sale for only 9% of its value."

Without a diatribe and examination of all of the state laws on tax sales, we shall examine Oklahoma's procedure. If a taxpayer decides not to pay his taxes, one may obtain from the County Treasurer a tax certificate for the payment of the delinquent taxes and collect, upon payment, the munificent sum of 8% interest. If the third party accumulates three years of tax certificates, he may apply for a tax deed by filing an application and notifying the owner under due process. As well, where the county has bought the property for taxes, it may offer the property to the highest bidder at a treasurer's tax sale.

It might be appropriate to point out that in Oklahoma we have 77 counties, each with their obligation to raise revenues from their *ad valorem* tax base. Over half of those counties are unable to advertise and mail notices of tax sales for the reason the cost involved exceeds their available funds. To invade the sovereignty of states and counties to conduct tax sales under § 548 touches upon a Tenth Amendment invasion. See *Garcia v San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 105 S.Ct. 1005, 83 L.Ed.2d 1016 (1984).

Amici for the Petitioner have afforded this Court a valuable service in that they have pointed out the potential disaster that will be wrought upon the thousands of

taxing entities of the states if this Court is to rule that substantive state law of the individual states is pre-empted by § 548. It simply would mean that no purchaser of property from a county could dispose of the property acquired at a tax sale for a period of one year out of fear of attack by a bankruptcy trustee. And the guarantee of a lien afforded to such purchasers for and in the amount of their investment really affords a rather empty promise.

In the context of tax sales, again *Amici* argue that voiding tax sales would achieve the over-riding policy of § 548 – to ensure that bankruptcy estates would not be depleted. Again, most of these instances, where applicable to a chapter 13 debtor(s), involve homesteads and exempt property. There, general creditors would not have been injured by the tax sales since they would not have had access to the homestead to satisfy their claims. And, it is clear, that such property does not pass to the trustee and is not part of the bankrupt estate, a point that *Amici* for the Petitioner has neglected to address.

Some courts have held that it is not within the purview of the judiciary to establish the policy of bankruptcy law. For example, see *In the Matter of Bundles, supra:* "It is beyond our scope of review to consider the policy implications of permitting the debtor to set aside the foreclosure of his home." 856 F.2d at 822.

As early as 1938 it was established by this court that congress has the power to alter state property rights. *Wright v Union Central Life Insurance Co.*, 304 U.S. 502, 58 S.Ct. 1025, 82 L.Ed. 1490 (1938) clearly stated the power:

If the argument is that Congress has no power to alter property rights, because the regulation of rights in property is a matter reserved to the states, it is futile. Bankruptcy proceedings constantly modify and affect the property rights established by state law. A familiar instance is the invalidation of transfers working a preference, though valid under state law.

Such action does not indicate a disregard of the property rights created by state law. The state law still establishes the norm to which Congress must substantially adhere; a serious departure from this norm, i.e., from the quality of the property rights created by the state law, has led to condemnation of the federal action as constituting a deprivation of property without due process.

> Property rights do not gain any absolute inviolability in the bankruptcy court because created and protected by state law. Most property rights are so created and protected. But if Congress is acting within its bankruptcy power, it may authorize the bankruptcy court to affect these property rights, provided the limitations of the due process clause are observed. 204 U.S. at 517-518.

Vanston Bondholders Protective Committee v Green, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946) again recognized the rule to be that "What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law." 329 U.S. at 161. What is important about *Vanston* is this Court took the position (at least with regard to following state law or

federal law in the application of interest) *"we would still have to decide whether allowance of the claim would be compatible with the policy of the Bankruptcy Act."* 329 U.S. at 161.

Butner is the touchstone case relied upon to defend the proposition that state law (non-bankruptcy law) is to be followed in the issue before us. Two points gleaned from that case govern our position here:

> Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a state serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.' 440 U.S. at 54.
>
> But undefined considerations of equity provide no basis for adoption of a uniform federal rule affording mortgagees an automatic interest in the rents as soon as the mortgagor is declared bankrupt. 440 U.S. at 55.
>
> What does follow is that the federal bankruptcy court should take whatever steps are necessary to ensure that the mortgagee is afforded in federal bankruptcy court the same protection he would have under state law if no bankruptcy had ensured. This is the majority view, which we adopt today. 44 U.S. at 56.

JWH, is arguing this case from the standpoint of a mortgagee that forecloses properties under default which

are the homestead of the mortgagors. From this standpoint, it is clear Congress desired to afford special treatment and protections to secured creditors who have a lien upon the principal residence of the debtor. This is clear from the statute, 11 USCS § 1322(b)(2), and from the latest decisions of this court in both *Rake* and *Nobelman*. Yet, both of those cases came before this Court from a refusal of the inferior courts to pay attention to text and the compulsion to fashion a federal rule in opposition to established state substantive law.

There is no basis for the fashioning of a federal rule that upsets validly conducted state foreclosure proceedings and validly conducted state and county tax sales. All states have in place uniform fraudulent conveyance or transfer acts. All states in which JWH does business have in place homestead exemption statutes which place the debtors' homes exempt from general unsecured creditors. In no instance can the foreclosure or the tax sale of a homestead be deemed to have injured unsecured creditors.

THIS COURT CANNOT INFER PREEMPTION OF STATE FORECLOSURE LAW AND STATE AND COUNTY TAX SALE LAW.

The tension arises between the federal bankruptcy Code and substantive state law. It can be argued, without real support, the Bankruptcy Code pre-empts state law on this subject. The Supremacy Clause "invalidates any state law that contradicts or interferes with an Act of Congress." *Missouri-Kansas-Texas Ry. Co v States*, 712 P.2d 40, 47 (Okla. 1985). A state law is invalid, *inter alia*, to the extent that it "actually conflicts with a . . . federal statute." *Ray v Atlantic Richfield Co.*, 435 U.S. 151, 158, 98 S.Ct.

988, 994, 55 L.Ed.2d 179 (1978), or when it "stands as an obstacle to the accomplishment and execution of the full purpose of Congress." *Hillsborough County v Automated Medical Laboratories, Inc.*, 471 U.S. 707, 713, 105 S.Ct. 2371, 2375, 85 L.Ed.2d 714 (1985), quoting *Hines v Davidowitz*, 312 U.S. 52, 67, 61 S.Ct. 399, 404, 85 L.Ed.2d 581 (1941).

Examination of *Cipollone v Liggett Group, Inc.*, 112 S.Ct. 2608, 2624-2626 (1992) reveals certain applicable principles:

> Our precedents do not allow us to infer a scope of pre-emption beyond that which clearly is mandated by Congress' language.
>
> We resort to principles of implied pre-emption – that is, inquiring whether Congress has occupied a particular filed with the intent to supplant state law or whether state law actually conflicts with federal law, see *English v General Electric, Co.*, 496 U.S. 72, 79, 110 S.Ct. 2270, 2275, 110 L.Ed.2d 65 (1990) – only when Congress has been silent with respect to pre-emption.
>
> Consideration under the Supremacy Clause starts with the basic assumption that Congress did not intend to displace state law.
>
> We are not to conclude that Congress legislated the ouster of this [state] statute . . . in the absence of an unambiguous congressional mandate to that effect.
>
> Any indulgence in construction should be in favor of the States, because Congress can speak with drastic clarity whenever it chooses to

assure full federal authority, completely displacing the States.

CONCLUSION

This Court should adopt the construction Congress has not pre-empted the field of state foreclosure law or the field of state tax sale law.

The rationale of the Ninth Circuit in the case at bar is the better approach in absence of clear, unambiguous evidence to the effect that Congress did not infer a scope of pre-emption such as to allow a bankruptcy court to ignore state substantive law.

To maintain the integrity of mortgage foreclosure law, this court should affirm the Ninth Circuit.

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APPENDIX

(54) "transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption;

§ 548. Fraudulent transfers and obligations

(a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily –

(1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(ii) was engaged in business or a transaction, or was about to engage in business or a

transaction, for which any property remaining with the debtor was an unreasonably small capital; or

(iii) intended to incur, or believe that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

(b) The trustee of a partnership debtor may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, to a general partner in the debtor, if the debtor was insolvent on the date such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation.

(c) Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545, or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

(d)(1) For the purposes of this section, a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of

the case, such transfer is made immediately before the date of the filing of the petition.

Rule 37.3 Consent to Filing
Amicus Curiae Brief

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July 1, 1993

Lawrence A. G. Johnson, Esq.
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Re: BFP v Resolution Trust Corp. No. 92-1370

Dear Mr. Johnson:

As requested in your letter, I hereby consent to the filing of an *amicus curiae* brief in the above captioned case.

Very Truly Yours,

/s/ Ray Woolsey
Ray Woolsey

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June 30, 1993

Lawrence A. G. Johnson
JOHNSON & SWENSON
2535 East 21st Street
Tulsa, Oklahoma 74114

BY FACSIMILE
AND U.S. MAIL

Re: BFP v. RTC
United States Supreme Court No. 92-1370

Dear Mr. Johnson:

In response to your letter of June 25, 1993, my clients Paul Osborne, et al., Repondents/Appellees in the pending appeal, hereby consent to your client, Jim Walter Homes, Inc., filing an amicus brief in the above-captioned case. For your information, the Petitioner's/Appellant's brief is due July 8, 1993.

Please call me if you need anything else or have any questions. Thank you for your interest and assistance.

Very truly yours,

/s/ Michael R. Sment
MICHAEL R. SMENT

MRS:sat

(SEAL)

U. S. Department of Justice
Office of the Solicitor General

Washington, D.C. 20530

June 29, 1993

Lawrence A.G. Johnson, Esquire
Johnson & Swenson
Attorneys and Counselors at Law
2535 East 21st Street
Tulsa, Oklahoma 74114

Re: BFP v. Resolution Trust Corp., No. 92-1370

Dear Mr. Johnson:

As requested in your letter of June 25, 1993, I hereby consent to the filing of an *amicus curiae* brief in the above-captioned case.

Sincerely,

/s/ Drew S. Days, III/as
Drew S. Days, III
Solicitor General

cc: William K. Suter, Esq.
Clerk
Supreme Court of the United States
Washington, D.C. 20543